MEMORANDUM

February 19, 2009

RE: Qualified Zone Academy Bonds

BACKGROUND

In October, 2008, as part of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, which was included in the Emergency Economic Stabilization Act of 2008 (the *"Stabilization Act"*), Congress enacted Section 54E of the Internal Revenue Code of 1986, as amended (the *"Code"*). Section 54E revised the provisions applicable to qualified zone academy bonds, which were originally governed by Section 1397E of the Code. In February, 2009, as part of the American Recovery and Reinvestment Act of 2009 (the *"Recovery Act"*), Congress (i) increased the volume limitation for qualified zone academy bonds, (ii) imposed certain wage rate requirements and labor standards on projects financed with proceeds of qualified zone academy bonds, and (iii) explicitly permitted regulated investment companies to pass through tax credits from qualified zone academy bonds to the shareholders of the regulated investment companies. Owners of qualified zone academy bonds will receive a tax credit if they own qualified zone academy bonds on one or more credit allowance dates (there is no longer the concept of an eligible taxpayer; qualified zone academy bonds can be purchased by any investor). This memorandum contains a brief summary of the provisions governing the issuance of qualified zone academy bonds.

Please note that Section 1397E does not apply to any obligations issued after October 3, 2008, the date of enactment of the Stabilization Act, and that Section 54E governs the issuance of qualified zone academy bonds issued after October 3, 2008. Provisions of the Treasury regulations issued under Section 1397E with respect to qualified zone academy bonds (the "*Final Regulations*") that do not conflict with the provisions of Section 54E should (subject to further guidance) continue to be applicable to qualified zone academy bonds issued pursuant to Section 54E. Qualified zone academy bonds are governed by Sections 54E and 54A of the Code.

Owners of qualified zone academy bonds are provided a federal income tax credit to offset their regular federal income tax liability, rather than receiving interest on the bond. The amount of the credit is treated as interest and is included in gross income. The owners will receive the credit if they hold a qualified zone academy bond on one or more credit allowance dates during any taxable year. The amount of the credit with respect to any credit allowance date is 25 percent of the annual credit determined with respect to the bond. The annual credit is equal to one hundred percent of the product of the credit rate (determined by the Secretary of the Treasury (the *"Secretary"*) for the date on which the bond was sold) multiplied by the outstanding face amount of the bond.

The credit allowance dates are March 15, June 15, September 15 and December 15, and also include the last day on which the bond is outstanding. In the case of a bond issued, redeemed, or maturing between credit allowance dates, the amount of the credit will be a ratable portion of the credit based on the portion of the three-month period during which the bond is outstanding. The credit rate is determined daily and is the rate the Secretary estimates will generally permit the issuance of qualified zone academy bonds with a specified maturity or redemption date without discount and without interest cost to the issuer. Pursuant to Notice 2009-15, the Treasury will publish credit rates for qualified zone academy bonds daily at http://www.treasurydirect.gov. The credit rate is based on the Treasury's estimate of the yields on outstanding bonds from market sectors selected by the Treasury in its discretion that have an investment grade rating of between A and BBB for bonds of a similar maturity for the business day immediately preceding the sale date. The sale date is the first day on which there is a binding, written contract for the sale or exchange of the qualified zone academy bond.

In general, the credit for any taxable year cannot exceed the excess of the sum of regular tax liability plus the alternative minimum tax over the sum of most credits allowable under the Code. Any excess credit will be carried to the succeeding taxable year.

QUALIFIED ZONE ACADEMY BONDS

Qualified zone academy bonds are taxable obligations of a State or local government that meet certain criteria. Under the Final Regulations, qualified zone academy bonds may be issued on behalf of a State or local government under rules similar to those for determining whether bonds that are issued on behalf of a State or political subdivision constitute obligations of a State or political subdivision for purposes of Section 103 of the Code. In addition to the various rules discussed below, the requirements that must be satisfied to constitute an issue of qualified zone academy bonds include the following:

(i) 100 percent of the available project proceeds of the issue must be used for qualified purposes at a qualified zone academy;

(ii) the academy must be located within the jurisdiction of the issuer;

(iii) the issuer must designate the obligations as qualified zone academy bonds; and

(iv) the issuer must certify that it has written assurances that the private business contribution requirement will be met with respect to the qualified zone academy and the issuer must certify that it has received written approval from an eligible local education authority (*i.e.*, a local education agency defined in Section 9101 of the Elementary and Secondary Education Act of 1965) for the issuance of the qualified zone academy bonds.

Although qualified zone academy bonds are taxable bonds, two rules governing tax-exempt bonds issued by State or local governments are applicable to qualified zone academy bonds. These rules are the arbitrage rules and restrictions under Section 148 of the Code as modified by Section 54A and the reporting requirements under Section 149(e) of the Code, each of which is discussed below.

QUALIFIED ZONE ACADEMY

The term “qualified zone academy” generally means a public school (or academic program within a public school) that is established by and operated under the supervision of an eligible local education agency to provide education or training below the post-secondary level if (i) the public school or program is designed in cooperation with the business community to enhance the academic curriculum, increase graduation and employment rates and better prepare students for the rigors of college and the increasingly complex workforce, (ii) students in the public school or program will be subject to the same academic standards and assessments as other students educated by the eligible local education agency, (iii) the comprehensive education plan of the public school or program is approved by the eligible local education agency and (iv) either the public school is located in an empowerment zone or enterprise community or there is a reasonable expectation (as of the date of issuance of the qualified zone academy bonds) that at least 35 percent of the students attending the school or participating in the program will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

QUALIFIED PURPOSE

The “qualified purposes” that proceeds of a qualified zone academy bond can be expended on are as follows: (i) rehabilitating or repairing the public school facility in which the academy is established, (ii) providing equipment for use at such academy, (iii) developing course materials for education to be provided at such academy and (iv) training teachers and other school personnel in such academy.

100 PERCENT TEST

As discussed above, the Code requires that 100 percent of the available project proceeds of an issue of qualified zone academy bonds be used for one or more qualified purposes. “Available project proceeds” means the excess of (i) the proceeds from the sale of an issue (and investment earnings thereon) over (ii) the issuance costs financed by the issue (to the extent that such costs do not exceed two percent of such proceeds). Thus, it appears that no more than two percent of the proceeds of an issue can be used for costs of issuance.

PRIVATE CONTRIBUTION

The private business contribution is satisfied if the eligible local education agency that established the qualified zone academy has written commitments from private entities to make qualified contributions to the qualified zone academy. Private entities must have committed to make qualified contributions having a present value, as of the date the qualified zone academy bonds are issued, of not less than 10 percent of the proceeds of the issue. Qualified contributions are any combination (of a type and quality acceptable to the eligible local education agency) of equipment; technical assistance in developing a curriculum or in training teachers to promote appropriate market driven technology in the classroom; services of employees as volunteer mentors; internships, field trips or other educational opportunities outside the academy for students; or any other property or services specified by the eligible local education agency. The Final Regulations provide that for these purposes a "private entity" includes any person (as defined in Section 7701(a)) other than the United States, a state or local government or any agency or instrumentality thereof or related party. Under this definition, a private entity includes 501(c)(3) organizations and individuals. The Final Regulations clarify that cash can constitute a private business contribution, provided that the cash is to be used for the items listed above. However, under the Final Regulations, the services of employees of an eligible local education agency do not qualify as a private business contribution. Finally, the preamble to the Final Regulations indicates that the issuer's certification that it has written assurances of the necessary private business contributions will be respected if the certifications are reasonably made.

SPECIAL EXPENDITURE RULES

As of the date of issuance of the qualified zone academy bonds, the issuer must reasonably expect that (i) 100 percent or more of the available project proceeds of the issue will be spent for one or more qualified purposes within three years of the date of issuance of the bonds (although this period may be extended by the Secretary, if requested prior to the expiration of the three-year period, due to reasonable cause and if the expenditures for qualified purposes will continue to proceed with due diligence); and (ii) a binding commitment with a third party to spend at least ten percent of such available project proceeds will be incurred within six months of the date of issuance. To the extent that the 100 percent test is not met by the close of the three-year period, all nonqualified bonds must be redeemed within 90 days of the end of the period. The amount of nonqualified bonds required to be redeemed is determined in the same manner as used under Section 142 of the Code for exempt facility bonds.

SPECIAL ARBITRAGE RULES

The issuer must comply with the arbitrage rules of Section 148 of the Code with respect to the proceeds of the issue. However, an issue will not be treated as failing to comply with the arbitrage rules by reason of any investment of available project proceeds during the expenditure period (*i.e.*, the three year period after the date of issue of the qualified zone academy bonds).

An issue will also not be treated as failing to comply with the arbitrage rules under Section 148 by reason of any fund that is expected to be used to repay such issue if (i) such fund is funded at a rate not more rapid than equal annual installments; (ii) such fund is funded in a manner reasonably expected to result in an amount not greater than an amount necessary to repay the issue; and (iii) the yield on such fund is not greater than the discount rate used by the Secretary to calculate the maturity limitation of the issue (discussed immediately below).

MATURITY LIMITATION

The maturity of an issue of qualified zone academy bonds cannot exceed the maximum term determined by the Secretary. The Secretary will determine the maximum term for bonds issued during a certain calendar month by using the term that will result in the present value of the obligation to repay the principal on the bond being equal to fifty percent of the face amount of such obligation. Such present value will be determined by using as a discount rate the average annual interest rate of tax-exempt obligations having a term of ten years or more which are issued during the month.

STRIPPED CREDITS

The Secretary is permitted to issue regulations concerning the separation of the tax credit from the underlying bonds. In general, there may be a separation (including at issuance) of the ownership of a qualified zone academy bond and the entitlement to the credit with respect to such bond. In case of any such separation, the credit will be allowed to the person who on the credit allowance date holds the instrument evidencing the entitlement to the credit and not the holder of the bond.

In the case of such separation, the rules of Section 1286 (tax treatment of stripped bonds) will apply to the qualified zone academy bond as if it were a stripped bond and to the credit as if it were a stripped coupon.

CONFLICT OF INTEREST

The issuer of qualified zone academy bonds must certify that (i) applicable state and local law requirements governing conflicts of interest are satisfied with respect to such issue; and (ii) if the Secretary prescribes additional conflict of interest rules governing the appropriate Members of Congress, Federal, State and local officials, and their spouses, such additional rules are satisfied with respect to such issue.

INFORMATION REPORTING

In connection with the issuance of qualified zone academy bonds, an issuer will be required to file with the Internal Revenue Service a report similar to those currently required to be filed with respect to tax-exempt obligations.

VOLUME LIMITATION

The Code restricts the amount of qualified zone academy bonds that can be issued in a particular calendar year. The Recovery Act extends the qualified zone academy bonds program into 2010 and provides a limitation of $1,400,000,000 for each of the years 2009 and 2010. The national volume limitation for a calendar year is allocated by the Secretary among the States on the basis of their respective populations of individuals below the poverty line and is allocated by the State education agency to qualified zone academies within such State.

Unused volume cap can be carried forward for the first two years following the unused limitation year. Volume cap that is carried forward will be treated as used on a first-in first-out basis. Any carryover under Section 1397E(e)(4) to 2008 or 2009 will be allowed to be issued if the new provisions of Section 54E are satisfied.

RICs Allowed to Pass Through Tax Credit Bond Credits

A regulated investment company (*"RIC"*) may elect to pass through tax credits received from qualified zone academy bonds to shareholders of the RIC.

Wage and Labor Standards

Wage rate requirements and certain labor standards set forth in Subchapter IV of Chapter 31 of Title 40, United States Code, apply to projects financed with the proceeds of any qualified zone academy bond.